In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 168

MT. MANSFIELD TELEVISION, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEOMRANDUM FOR THE UNITED STATES IN OPPOSITION

In 1956 petitioner, which operates a television station in South Burlington, Vermont, wished to obtain microwave equipment used for transmitting television signals. After discussions with both the supplier of the equipment and petitioner's tax counsel regarding the tax advantages of lease versus purchase, petitioner "leased" the equipment for 5 years with an option to renew for successive annual periods (apparently indefinitely) (Pet. 11-13). The parties set the

amount of the monthly "rent" so that the "rental" payments in the initial 5 years would pay the purchase price of the equipment plus approximately 4% interest (Pet. 13, R. 8-9).[1] After 5 years the "rental" payments automatically dropped from $748 per *month* to $747 per *year* (Pet. 13). Petitioner-"lessee" at all times bore the risk of loss or damage to the equipment and was obliged to pay all insurance, taxes and repairs (Pet. 12-13). The lease did not give petitioner any option to acquire legal title to the equipment (Pet. 13).

The district court held that in substance the transaction constituted a sale rather than a lease. It thus disallowed petitioner's claimed deductions for rent paid and instead permitted petitioner to depreciate the microwave equipment over its useful life of 15 years and to deduct the portion of the "rental" payments that were actually interest on the purchase price (Pet. 14). The Court of Appeals for the Second Circuit affirmed *per curiam* (Pet. 8-9).

If form were the controlling factor, a taxpayer who was in fact acquiring virtually full ownership of an asset could bunch his deductions in the early years by paying a high initial "rental" followed by either a renewal lease at a nominal "rental" or a purchase for a nominal purchase price. Consequently, in cases such as this one the courts have uniformly held that the tax incidence of the transaction turns on economic reality rather than the language used in drafting the

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[1] "R." references are to the government's printed appendix in the Court of Appeals.

formal documents and thus that a document which is in form a "lease" may in fact be a sale. See *Oesterreich* v. *Commissioner*, 226 F. 2d 798 (C.A. 9); *Starr's Estate* v. *Commissioner*, 274 F. 2d 294 (C.A. 9); *Breece Veneer & Panel Co.* v. *Commissioner*, 232 F. 2d 319 (C.A. 7); *Meiselman* v. *Commissioner*, 300 F. 2d 666 (C.A. 4); *Rotorite Corp.* v. *Commissioner*, 117 F. 2d 245 (C.A. 7); *Western Contracting Corp.* v. *Commissioner*, 271 F. 2d 694 (C.A. 8); *Benton* v. *Commissioner*, 197 F. 2d 745 (C.A. 5).

Petitioner does not dispute this basic principle; instead it argues that a transaction which takes the form of a "lease" can never be a sale unless the "lessee" has an option to purchase the property.

1. The taxpayer-"lessee" is willing to pay a higher "rental" than reasonable in the early years only if he is entitled to use the property for less than a reasonable "rental" in later years. There are a number of ways in which the "lessee" can be assured of continued use of the property for less than an arm's-length "rental" in the later years, one of which is giving him an option to buy the property for less than its fair value. Another equally effective method is to give the "lessee" an option to renew his lease indefinitely or for a period approximately as long as the life of the asset at a nominal or less than arm's-length "rental." Thus, whenever the "practical effect" of the arrangement between the parties is to give the "lessee" virtually full ownership of the property, the courts have treated the transaction as in substance a sale, regardless of the form of device used. See *Starr's Estate* v. *Commis-*

sioner, 274 F. 2d 294 (C.A. 9), where, as here, the court examined the "practical effect" of the transaction and found that a purported lease without an option to buy was in substance a sale.

2. Despite the "lease" language in which petitioner couched the instant transaction, the district court and court of appeals found that in substance virtually full ownership in the property was transferred to petitioner and that the parties intended it to be a conditional sale rather than a lease (Pet. 16). The "rent" was computed so that at the end of 5 years the "lessor" would have recovered the selling price of the equipment plus 4% interest (Pet. 17).[2] Thereafter petitioner was entitled to retain the equipment for the remainder of its useful life by paying less than 1/12 of the initial annual "rental" (Pet. 17). Moreover, the "lease" provided that if the property should be destroyed for any reason during the first year, petitioner would pay the "lessor" an amount which was approximately the purchase price of the equipment; this amount declined each year as petitioner made "rental" payments on the property (Pet. 17). The holdings of both courts below that the instant transaction was in substance a conditional sale rather than a lease is amply supported by the evidence.

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[2] In fact, the lease stated that the monthly payments included interest at approximately 4%, something that is highly unusual for rental payments (Pet. 17).

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted.

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